

**AGENDA ITEM 6
MARCH 14, 2006**

ATTACHMENT B

**REQUEST FOR PROPOSAL: BOARD OF
ADMINISTRATION'S INDEPENDENT FINANCIAL
STATEMENT AUDITOR**

**AGENDA ITEM 6, FEBRUARY 10, 2006,
WITH CHANGES MARKED**

Members of the Finance Committee
February 10, 2006

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February 10, 2006

AGENDA ITEM 6

TO: MEMBERS OF THE FINANCE COMMITTEE

- I. SUBJECT:** Request for Proposal: Board of Administration's Independent Financial Statement Auditor
- II. PROGRAM:** Audits
- III. RECOMMENDATION:** Staff requests the Finance Committee recommend to the Board of Administration approval of staff's recommendations for the issuance of a Request for Proposal to obtain the services of a qualified audit firm to audit CalPERS' financial statements beginning with Fiscal Year 2006/2007 and ending with Fiscal Year 2010/2011.
- IV. ANALYSIS:**

BACKGROUND

Section 20228 of the Government Code requires the Board of Administration to annually employ a Certified Public Accountant to audit CalPERS' financial statements. This law limits the engagement of the Certified Public Accountant to a maximum of five years. The five-year term of the current Board's auditor, Deloitte & Touche, LLP, will expire with the conclusion of the 2005-2006 financial statement audit. Therefore, this RFP begins the procurement process for an independent financial statement auditor for 2006-2007 financial statements and the financial statements of the following four fiscal years.

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The Finance Committee's responsibilities in procuring and overseeing the services of the financial statement auditor are described in the Finance

Committee Charter. This agenda item has been prepared by staff to aid the Finance Committee in this process as required by both the Finance Committee Charter and the Office of Audit Services Charter. Specifically, the Finance Committee Charter has the following passage:

“B. Independent External Financial Statement Auditor

1. To review the responses received to solicitations sent to auditing firms and to recommend the selection of the independent auditors to be engaged by the Board. This process occurs every five years under Government Code, Section 20228, which states that an auditor may not serve two consecutive terms.”

DISCUSSION

The Request for Proposal is designed to solicit qualified Certified Public Accounting firms to competitively bid for engagement as the Board's independent financial statement auditor. The proposal envisions awarding a contract to the successful bidder to audit for five successive fiscal years from 2006/07 through 2010/2011. However, the actual term of the contract is for 5 and one-quarter (5-1/4) years to allow for transition from one auditor to the next. This is necessary because the audit of a fiscal year, such as 2004/2005, is performed during the period July through October of the following fiscal year, and the reports may be presented to the Finance Committee during November, December and February of this same following fiscal year. *Therefore, staff recommends that contract duration be extended to 5-1/4 years, which is beyond the Board's policy of 5 years.*

In the Year 2000, the last Request for Proposal attracted only two qualified bidders. While these two bidders were highly qualified firms, there remained the question of whether the Board was receiving the services at a reasonable cost given the absence of additional bidders. To address this issue, staff analyzed the last Request for Proposal process and modified the Request for Proposal to broaden the ability for more Certified Public Accounting firms to bid on the engagement. Staff believes that we can attract a wider range of bidders by modifying the Minimum Qualifications without significantly reducing the audit quality obtained. A summary of modifications to the Minimum Qualifications in this Request for Proposal is presented in Attachment A. The major changes since the last Finance Committee review of independent auditor responsibilities are discussed briefly as follows.

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Joint Venture Policy Variance. With the last Request for Proposal, a significant barrier to potential bidders was the requirement that a primary bidder lacking expertise in an area had to form a joint venture with another firm in order for the other firm's expertise to be allowable for meeting Minimum Qualifications per CalPERS' Joint Venture Policy (mix and match their individual experience and qualifications for meeting the Minimum Qualifications). Consequently, smaller audit firms would have to obtain actuarial expertise through a joint venture with an actuarial firm to meet two Minimum Qualifications of the last Request for Proposal. Actuarial firms were then and still are not willing to enter into joint ventures for this purpose. Therefore, we propose allowing the primary firm to subcontract for needed actuarial expertise as required. Staff believes this change is necessary because many audit firms do not have in-house actuaries. After consultation with the Legal Office, the staff of the Office of Audit Services recommends a variance from the Joint Venture Policy. *Staff recommends permitting cumulating experience and qualifications between partnering firms without forming joint ventures for actuarial services as specifically described in the Minimum Qualifications of Attachment A, Items 1 and 4 of this Agenda Item.*

Experience for Key Personnel and Firm Experience in Auditing Classes of Investments. In order to increase the potential number of bidders, staff has established the minimum number of years of experience required for each Minimum Qualification for the key personnel, as outlined in the Minimum Qualifications, Attachment A, Items 9, 10, and 11. We believe that persons meeting these qualifications will be able to provide a sufficient quality of services to CalPERS. *Staff recommends approval Items 9, 10, and 11 in the Minimum Qualifications, Attachment A.*

Staff believes that audit experience with different types of investment vehicles is necessary, but staff recommends changing the threshold of prior audit experience for each investment vehicle as outlined in Attachment A, Item 3. Staff believes that this change is prudent. In addition, the other Minimum Qualifications are outlined in Items 2, 5, 6, 7, 8, 12, 13, and 14 in Attachment A. *Staff recommends approval of the remaining Minimum Qualifications, 2, 3, 5, 6, 7, 8, 12, 13, and 14, listed in Attachment A.*

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Schedule. The proposed schedule for the RFP process is shown below.

PROPOSED SCHEDULE OF EVENTS

RFP Release Date	February 16, 2006 <u>March 20, 2006</u>
Deadline to Submit Written Technical Questions	March 13, 2006, 1:00 p.m. PST <u>April 17, 2006, 1:00 p.m. PST</u>
Mail Response to Written Questions	March 20, 2006 <u>April 27, 2006</u>
Final Filing Date	April 27, 2006 at 3:00 p.m. PST <u>May 31, 2006 at 3:00 p.m. PST</u>
Preliminary Review*	April 28, 2006 through May 3, 2006 <u>June 1, 2006 through June 5, 2006</u>
Evaluation of Proposals*	May 4, 2006 through May 8, 2006 <u>June 6, 2006 through June 9, 2006</u>
On-site Visits (Optional)	TBD
Finalists Selected and Notified*	May 10, 2006 <u>June 12, 2006</u>
Finalists Interviews* (time to be determined)	June 16, 2006
Finance Committee Meeting	<u>August TBD, 2006</u>
Post Notice of Intent to Award*	TBD
CalPERS Anticipated Contract Performance Start Date*	January 1, 2007

* All dates after the Final Filing Date are tentative and are subject to change by CalPERS upon written notification to all Proposers.

The proposed date of release of the RFP is **Monday, March 20, 2006** ~~February 16, 2006, the day of the Board meeting.~~ The RFP process includes a final filing date of **May 31, 2006** ~~April 27, 2006.~~ The Finance Committee will interview and score the finalists at the ~~June 16, 2006 meeting~~ **an August TBD, 2006 meeting** **in order to give the successful bidder time to prepare to begin the contract**

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on January 1, 2007. This will require a special August meeting of the Finance Committee. The Finance Committee will recommend to the Board of

Administration the selection of CalPERS' independent financial statement auditor, consistent with the Finance Committee Charter. *Staff recommends approval of the proposed schedule of events **and an additional meeting of the Finance Committee on August TBD, 2006, to hear the finalists' proposals.***

Scoring. The scoring for the RFP will be as follows.

	<u>Feb. 10</u>	<u>March 14</u>
Technical Proposal.....	100 points	<u>200 points</u>
Fee Proposal.....	100 points	100 points
Finance Committee	<u>200 points</u>	<u>200 points</u>
Total.....	<u>400 points</u>	<u>500 points</u>

The Finance Committee scoring will be conducted according to CalPERS' policy as described below.

Upon completion of the interview process, the Finance Committee will rank Finalists by motion. **The highest ranked Finalist will receive 200 points, the second highest will receive 150 points, the third highest 100 points and the fourth highest 50 points.** ~~The highest ranked Finalist will receive 200 points, and the remaining Finalists will receive points proportionate to their ranking. The incremental difference between Finalists' interview points is derived by dividing the maximum number of points (200) by the number of Finalists eligible for and participating in an oral interview with the CalPERS Finance Committee. Each Finalist's score will be combined with its Technical and Fee Proposals scores, as prescribed on the Proposal "Evaluation Sheet."~~ **This mechanism of scoring requires an exemption from CalPERS policy, and this mechanism is desirable because only a very few bidders are expected to be finalists. Staff also notes that the proposed scoring allocates 20% of the total points to the cost proposal, which is below the 30% minimum that the Department of General Services uses and has been recently used by CalPERS.**

*Staff recommends approval of the scoring as described above, **including a variance from policy for scoring the finalists as described, and a variance from policy for scoring the fee proposal at 20% rather than a minimum of 30% of the total points in Department of General Services Guidelines.***

Staff believes that this RFP will result in an improved process to obtain bids for and selection of the next CalPERS' independent financial statement auditor.

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Summary of Recommendations. Staff seeks Finance Committee approval and recommendation to the Board of Administration for issuance of a Request for Proposal, which includes the following provisions:

- Proposed schedule of events, **including an August TBD meeting,**
- Minimum Qualifications as proposed in Attachment A
- Scoring, **with two variances from policies,**
- Exemption from CalPERS Joint Venture Policy
- Contract duration of five and one-quarter (5-1/4) years.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic Plan, but assists the Board of Administration in fulfilling its fiduciary role and statutory responsibility to secure an annual independent financial statement audit. This fiduciary role and statutory responsibility reside with the Finance Committee per the Finance Committee Charter.

VI. RESULTS/COSTS:

This item will result in solicitation of Certified Public Accounting firms to competitively bid on a five-year engagement as the Board of Administration's independent financial statement auditor. The costs will be determined by the cost proposal of the successful bidder.

Staff is available to answer questions of the Finance Committee Members.

Larry Jensen, Chief
Office of Audit Services

Peter H. Mixon
General Counsel